Supreme Court of Tennessee.

VANCE v. PHŒNIX INSURANCE CO.

Directors of a corporation are required to show reasonable capacity for the position, scrupulous good faith, and the exercise of their best judgment.

Directors, who act in good faith and with reasonable care and diligence, but nevertheless fall into a mistake, either of law or fact, are not personally liable for the consequence of such mistake.

The by-laws of a corporation provided that the board of directors should elect a secretary, whose term of office should be twelve months or until his successor was elected, and who was to give bond with security for the faithful discharge of his duties. The board elected a secretary, and took the prescribed bond, and re-elected the same person secretary for several successive years, but took no new bond, supposing, after consideration and discussion of the question, but without taking legal advice, that the bond taken was a continuing security during those years. The secretary became a defaulter in the third year. *Held*, that the directors, who were good and efficient business men, stockholders of the corporation, and acting in good faith, were not liable to make good the loss.

BILL by one stockholder of the Phœnix Insurance Company, upon the refusal of the company to bring the suit, to hold the directors of the company, during the year 1872 and 1873, individually liable for losses occasioned by their neglect to take an official bond from the secretary of the company, in accordance with the by-laws of the corporation.

By the charter the board of directors were authorized to appoint a secretary, &c., and to take from such secretary or other officers, such bonds and securities as may be prescribed by said board of directors. The company organized in February 1871, and adopted by-laws, prescribing, *inter alia:* "At the first regular meeting after the election of directors, the newly-elected board shall elect a president, secretary and assistant secretary, whose term of office shall be for twelve months, or until their successors are elected."

Another by-law was: "The secretary, after his election, shall give bond with satisfactory security to the board of directors, in the sum of $30,000, conditioned for the faithful discharge of his duties, and a failure to give such bond shall cause a forfeiture of his office." Other by-laws gave the secretary: "Special care and control over all books, papers and other documents" of the company; directed him to make regular deposits in bank of the money of the company, and authorized the money to be drawn out only on his check.

In February 1871, the board of directors appointed B. F. White secretary of the company, and took from him a bond, with satisfac-

tory security, in the penalty of $30,000, conditioned to faithfully perform his duty as such secretary, and in all respects properly demean himself in his said office. White was re-elected secretary in February 1872, and again in February 1873, but gave no new bond on either occasion, nor did the board require him to renew his bond. In 1873, White became a defaulter in the sum of $11,328.35, and also issued stock without authority, which the board of directors redeemed at an expense of $3050. The individual defendants were stockholders and members of the board of directors during the years 1872 and 1873. They received no compensation as directors, and gave to the business of the company their personal attention, and such attention, it was agreed, as men of ordinary prudence give their own affairs. They were all, by the agreed statement of facts, "good and efficient business men, several of them heads of large mercantile and manufacturing establishments." "The defendants supposed that the bond taken from White in 1871 was security for White's acts in 1872 and 1873, and so long as he acted as secretary of the company."

They considered and discussed the question of White's bond, and their conclusion was that it covered his acts for the whole time he should serve the company. In 1872 and 1873 they gave the business of said insurance company, and the sufficiency of White's bond, that care and attention which prudent men give their own affairs. They did not, however, take advice of counsel as to the sufficiency of the bond or of its binding force, but acted on their own judgment in regard to it until after White's defalcation occurred."

The chancellor dismissed the bill, whereupon complainant appealed.

The opinion of the court was delivered by

COOPER, J.—Directors of a corporation undoubtedly occupy a fiduciary relation towards the stockholders, and are bound to good faith and reasonable diligence in the performance of their duties. They are consequently liable for losses occasioned by their positive misconduct or neglect which warrants the imputation of fraud, or, as it is sometimes vaguely expressed, shows a want of the knowledge necessary for the discharge of their functions so great that they were not justified in assuming the office. Where they are interested in the stock of the company, and act without compensation, they will, at the utmost, be held to answer for ordinary neglect, that is for the omission of that care which every man of ordinary prudence

gives to his own affairs. They do not undertake to be infallible. For error, therefore, though it be in a matter of law, they are not in general, liable. In fine, they are required to show only a reasonable capacity for the position, scrupulous good faith, and the exercise of their best judgment. These principles are recognised in our decisions: *Shea* v. *Knoxville & Ky. Railroad Co.*, 6 Baxt. 277, 283; *Shea* v. *Mabry*, 1 Lea 319, 343. In this last case, it is conceded that directors, who act in good faith, and with reasonable care and diligence, but nevertheless fall into a mistake, either as to law or fact, are not liable for the consequences of such mistake. To the same effect are the authorities elsewhere: *Turquand* v. *Marshall*, Law Rep. 4 Ch. App. 376; *Godbold* v. *Branch Bank*, 11 Ala. 191; *Spering's Appeal*, 71 Penn. St. 11; *Scott* v. *Depeyster*, 1 Edw. Ch. 513; *Hodges* v. *New England Screw Co.*, 1 R. I. 312; s. c. 3 R. I. 9.

The act complained of in this case was the failure to take from the secretary a new bond upon his re-election in 1872, and again in 1873, upon the supposition that the bond given in 1871, did not bind the sureties beyond the re-election at the end of the first twelve months. It has been held that the failure to require the secretary of a corporation to give a bond, would make the president, whose duty it was to take the bond, liable for the defalcation of the secretary: *Pontchartrain Railroad Co.* v. *Paulding*, 11 La. Rep. 41. If this be conceded to be good law, as perhaps it may, it would not necessarily fix liability on the defendants in the present case, for the by-law only requires the secretary to give a bond for the faithful discharge of his duties, and such a bond was taken. The neglect of duty was in not requiring a new bond on each re-election of the same person. If the by-law had plainly required a new bond each year, or if, the language of the by-law admitting of doubt, the directors had come to the conclusion that a new bond should be taken, the authority would have been in point; so too, if the directors had known that, as matter of law, the sureties would not be bound beyond the year, and yet neglected to require a bond. The by-law does not, however, plainly require a new bond each year, and the agreed statement of facts concedes that the defendants considered and discussed "the question of the bond, and reached the conclusion that the bond taken covered his acts for the whole time he should serve the company." It was at most a mistake of law, on errors of judgment, for which, without

more, they would not be liable. There is of course, no pretence for charging the defendants upon the ground of a want of knowledge necessary to discharge their functions, so great that they were not justified in assuming the office, for it is conceded that they were "good and efficient business men, several of them the heads of large mercantile and manufacturing establishments." Now, can they be charged with neglect of duty, it being agreed that they gave to the business of the company, and the matter of the secretary's bond, "that care and attention which prudent men give their own affairs." It is not pretended that there was any bad faith. There is, therefore, clearly no ground for holding the defendants liable, unless it be for failing to take legal advice. But, the very fact that a mistake of law will not, of itself, create liability, necessarily implies that such a mistake may be committed without legal advice. Some of the cases do hold that acting under legal advice may tend to protect against liability, while none of them decide that its absence insures liability. Ordinarily, the advice of counsel will not protect a trustee: Perry on Trusts, § 927. Nor shield any person from the consequences of a wrongful or illegal act: *Kendrick* v. *Cypert*, 10 Humph. 291. The true rule in this class of cases is that if the directors feel any doubts as to the law, they may be guilty of neglect if they fail to seek and be guided by competent legal advice, and this for the obvious reason that they would, under like circumstances, seek such advice in the management of their private affairs.

The chancellor's decree is affirmed with costs.

Supreme Court of Missouri.

KEITH ET AL. *v.* HOBBS.

State courts have the right to inquire into the validity of a patent for an invention issued by the United States when the question comes up collaterally, as where an action on a promissory note given in consideration of the assignment of an interest in a patent is defended on the ground that the patent is void.

It is a good defence to an action on a promissory note given in consideration of the assignment of the right to make, use and vend a patented article within a limited territory, that while the specifications accompanying the letters-patent call for water as one of the ingredients to be used in the composition of the article, the waters in common use in a portion of the territory sold, by reason of their alkaline properties, or for other reasons, will not produce the desired result. Such specifications are insufficient, the patent is void, and the assignment constitutes no consideration for the note.